EXHIBIT 3

GOVERNOR OF PUERTO RICO
Ricardo Rosselló Nevares

May 6, 2018

The President
The White House
1600 Pennsylvania Avenue, N.W.
Washington, DC 20500

The Honorable Paul Ryan, Jr.
Speaker
United States House of Representatives
Washington, DC 20515

The Honorable Mitch McConnell
Majority Leader
United States Senate
Washington, DC 20510

The Honorable Nancy Pelosi
Democratic Leader
United States House of Representatives
Washington, DC 20515

The Honorable Charles E. Schumer
Democratic Leader
United States Senate
Washington, DC 20510

Re: Explanation for Government of Puerto Rico's Rejection of Fiscal Plan Recommendations

Dear President Trump, Speaker Ryan, Senator McConnell, Senator Schumer, and Representative Pelosi:

The Financial Oversight and Management Board for Puerto Rico (the "Oversight Board" or "Board") has submitted to the elected Government of Puerto Rico (the "Government") recommendations in connection with the New Fiscal Plan for Puerto Rico (the "Board Fiscal Plan") as certified on April 19, 2018. We have informed the Board pursuant to section 205(b)(1) of the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"), 48 U.S.C. §§ 2101–2241, that the Government, in the exercise of its policy making powers, believes the Board's recommendations are inappropriate and has declined to adopt them.[1] As required by

[1] Section 205(b)(1) provides that "[i]n the case of any recommendations submitted under subsection (a) that are within the authority of the territorial government to adopt, not later than 90 days after receiving the recommendations, the Governor or the Legislature (whichever has the authority to adopt the recommendation) shall submit a statement to the Oversight Board that provides notice as to whether the territorial government will adopt the recommendations."

PROMESA section 205(b)(3), I am submitting the Government's explanation as to why the Board's recommendations made in connection with the Board Fiscal Plan have been rejected.[2]

BACKGROUND

On April 5, 2018, we submitted to the Board our own fiscal plan that proposed Puerto Rico's most significant set of reforms in 50 years and one of the most aggressive fiscal agendas in the modern history of the United States, which would yield $3.1 billion of savings and revenue improvements by fiscal year 2023. Our fiscal plan demonstrated my Administration's willingness to make the difficult decisions required to put Puerto Rico on a path to fiscal responsibility and economic recovery. That plan was the culmination of extensive negotiation and collaboration with the Board, yielding agreement on the vast majority of the Government's assumptions and proposed structural and fiscal reforms. The Board nevertheless rejected our plan and in its place certified the Board's own plan on a divided vote. The Board Fiscal Plan seeks to impose on the Government an ancillary set of recommendations that include unsound and inappropriate measures that would potentially cause Puerto Rico's fiscal and humanitarian crises to spiral out of control and into chaos.

The Board's recommendations are based on conjectural and speculative forecasts that go well beyond the mandated six-year fiscal plan that we submitted to the Board. The Board is essentially gambling that additional austerity measures imposed on Puerto Rico would create economic benefits, which are purely aspirational in nature, many years into the future. As explained below, these recommendations are built on a faulty set of assumptions and, if implemented, would only harm the people of Puerto Rico and risk additional outmigration from the Island. Indeed, one member of the Oversight Board voted against certifying the Board's fiscal plan for the very same reasons the Government cannot and will not adopt the Board's recommendations.[3]

Purpose of Fiscal Plan and Broad Guidelines Under PROMESA

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[2] Section 205(b)(3) provides that "[i]f the Governor or the Legislature (whichever is applicable) notifies the Oversight Board under paragraph (1) that the territorial government will not adopt any recommendation submitted under subsection (a) that the territorial government has authority to adopt, the Governor or the Legislature shall include in the statement explanations for the rejection of the recommendations, and the Governor or the Legislature shall submit such statement of explanations to the President and Congress."

[3] *See* Ana J. Matosantos, Remarks at 12th Public Meeting of the Financial Oversight and Management Board for Puerto Rico at 40:13 (Apr. 19, 2018) ("I am simply not willing to support massive cuts to the safety net of low income seniors, children, and people with disabilities. Slashing funding to the Universidad de Puerto Rico, making the largest cutbacks to public pensions in the United States, and imposing innumerable additional austerity measures only is a beginning of more pain to come. I understand deep cuts are necessary, and have been and will continue to support what is needed to right the fiscal ship. But I cannot do that when that is all there is. I cannot support too much pain with too little promise. Austerity measures that generate near term surpluses but may very well lead to another fiscal cliff are not in the best interest of Puerto Rico, its retirees, creditors, or its future. I also heed the caution of experts who believe that growth assumptions under both plans are overly optimistic. In my view, there is simply too much risk, too much downside for the people of Puerto Rico and its future under these plans.").

PROMESA created the Oversight Board "to provide a method for [Puerto Rico] to achieve fiscal responsibility and access to the capital markets."[4] The Board's core function is to approve fiscal plans and budgets that serve as blueprints for Puerto Rico's restructuring efforts and reforms.[5] The Board must ensure that the fiscal plan satisfies 14 specific, but wide ranging, guidelines.[6] In particular, fiscal plans must cover at least a five-year period and include (i) projections of anticipated future government revenues and (ii) a broad plan for future government expenditures.[7] In addition to setting broad spending parameters, these guidelines require financial metrics to monitor the Government's progress toward its fiscal targets, including responsible accounting standards, timely financial reporting, and improved internal controls.[8]

With PROMESA's enactment, Congress sought to strike a careful balance between preserving the representative Government's flexibility to make policy decisions to achieve fiscal responsibility and entrusting the Board with a meaningful oversight role.[9] Congress granted the Board oversight authority to prevent past abuses, such as funding deficits through borrowing. In that regard, ensuring financial transparency and accountability to the Government's stakeholders is an essential element of the fiscal plan process.[10]

Under PROMESA's framework, the Board can make recommendations to the Government as to the policy choices needed to meet fiscal targets established in the certified fiscal plan.[11] But the Board cannot, through a series of anti-democratic measures[12], control or usurp the elected

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[4] PROMESA § 101(a), (b)(1).

[5] PROMESA § 101(d)(1), 201(c)(3), 201(e), 202(c)–(f). PROMESA looks in the first instance to the Government, not the Board, to develop and refine the fiscal plans and budgets. Opinion and Order Denying Urgent Motion of FOMB to Confirm Appointment of a Chief Transformation Officer, *In re The Fin. Oversight and Mgmt. Bd. for Puerto Rico*, Case No. 17 BK 3283-LTS (D. P.R. Nov. 16, 2017) [ECF No. 1820] at 10 (the "CTO Order"). While the Board can "certify its own fiscal plan and budget under certain circumstances," it may only do so when an "interactive process" with the Government does not yield a certifiable plan or budget. *Id.* (citing PROMESA § 201(d)(2)).

[6] PROMESA § 201(b)(1).

[7] *Id.* § 201(b)(1).

[8] *Id.* § 201(b)(1)(F).

[9] While the Board's fiscal planning powers "give it a strong and substantially determinative voice in overall strategy regarding the Commonwealth's revenues, expenses, and general direction for responsible financial management," the Board does not have the power to impose specific policies on the Government." CTO Order at 12. Rather, "Congress did not grant the [Board] the power to supplant, bypass, or replace the Commonwealth's elected leaders and their appointees in the exercise of their managerial duties whenever the Oversight Board might deem such a change expedient." *Id.*

[10] PROMESA § 201(b)(1)(F) (fiscal plan must "improve fiscal governance, accountability, and internal controls").

[11] CTO Order at 12.

[12] H.R. REP. 114-602(I) (2016) ("Under H.R. 5287, the anti-democratic provisions empowering the oversight board to impose its recommendations over the objection of the Puerto Rico government has been removed. The board is still authorized to make policy recommendations and to obtain a written response from the Puerto Rico government regarding whether it will, or will not, implement those recommendations. Section 201 does require the fiscal plan

Government's exclusive authority to determine the policies within the fiscal plan's parameters that are appropriate to protect the interests of the electorate to whom the Government is accountable.[13] Congress intended for the "governor and the board to work together for the benefit of the people of Puerto Rico, not to have parallel governing structures."[14]

Fiscal Plan Certification Process

On March 13, 2017, the Board certified the Commonwealth's fiscal plan for fiscal year 2018 (the "Original Fiscal Plan"), which provided for sustainable economic growth and long-term solvency while ensuring the well-being of the people of Puerto Rico. Under the Original Fiscal Plan, the Government included measures to address the Commonwealth's $52 billion in debt[15], in part, by making difficult decisions to implement structural and fiscal reforms that called for cuts to important government services.

On September 6, 2017, Hurricane Irma, a Category 5 storm, crossed a portion of the Island causing major disruption of power and damage. On September 20, Hurricane Maria, another Category 5 storm, made a direct landfall on Puerto Rico, crossing through the center of the Island. In its wake, Maria left the people of Puerto Rico reeling—physically and psychologically—especially considering that more than 45 percent of the Island lives near or below the poverty line. The aftermath of these storms left no corner of Puerto Rico untouched—Maria significantly damaged many homes; completely destroyed the power grid, leaving a vast portion of the Island in the dark for months; damaged the water system; rendered ports and airports unusable; washed away roads and bridges; and knocked out virtually all communications. In the hurricanes' aftermath there was no doubt that the Original Fiscal Plan would need to be reassessed to reflect Puerto Rico's new reality.

At its tenth public meeting held in San Juan on October 31, 2017, the Board passed a resolution recognizing the need for a revised fiscal plan and establishing a schedule for developing and certifying that plan. We were required to submit revisions to the Original Fiscal Plan by January 24, 2018. At the same time, the Board passed a resolution establishing nine guiding principles it would use to evaluate the fiscal plan revisions in addition to the 14 guidelines under PROMESA section 201(b)(1).

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put forward by the Puerto Rico governor to 'adopt appropriate recommendations' submitted by the oversight board under Section 205, but the term 'appropriate' provides the governor with significant flexibility to adopt sound recommendations and to decline to adopt unsound recommendations.").

[13] CTO Order at 12.

[14] *Id.*

[15] The Original Fiscal Plan covered debt issued by the following government entities: (i) Public Buildings Authority, (ii) Puerto Rico Sales Tax Financing Corporation, (iii) Puerto Rico Highways and Transportation Authority, (iv) Puerto Rico Convention Center District Authority, (v) Puerto Rico Infrastructure Financing Authority, (vi) Employees' Retirement System, (vii) University of Puerto Rico, (viii) Puerto Rico Industrial Development Company, and (ix) Government Development Bank.

On January 24, 2018, as the Board directed, we submitted an updated fiscal plan that addressed the new economic realities Puerto Rico faced in the wake of the devastating September hurricanes. On February 5, 2018, the Board issued a notice of violation with respect to the Government's new fiscal plan and extended the Government's deadline to submit a revised fiscal plan to February 12, 2018, which we subsequently met. On March 23, 2018, the Board announced it was postponing the certification of the fiscal plan scheduled for March 26, 2018. On March 28, 2018, the Board issued a letter identifying areas where it believed our fiscal plan should be further revised.

On April 5, 2018, we submitted to the Oversight Board a six-year fiscal plan that embodied our transformative vision to establish economic stability and prosperity for Puerto Rico. Our fiscal plan featured sweeping fiscal and structural reforms, including (among others) right-sizing measures and procurement reforms to increase operational efficiencies and structural initiatives such as tax reforms, ease-of-doing-business regulatory measures, power sector transformation, and welfare reforms (the "Government Fiscal Plan").

The measures in the Government Fiscal Plan generate significant savings by the end of the six-year period (2023), including a deep $2.5 billion annual reduction in Government expenditures, which reflects a 21.1 percent cut to controllable expenditures. More than half of these savings stem from right-sizing efforts, with the remainder coming from healthcare reform and subsidy reductions. The Government Fiscal Plan also includes a remarkable $522 million per year in incremental revenue enhancements primarily derived from rationalizing the tax code and improving tax compliance. These fiscal and structural measures, combined with forecasted long-term economic growth, result in an estimated annual surplus of approximately $1.4 billion by 2023.

Notwithstanding the strength of our plan, on April 18, 2018, the Board released its own fiscal plan and suggested further policy initiatives in the form of recommendations. These include (i) public employee pension cuts at the expense of some of Puerto Rico's most vulnerable citizens, (ii) additional public-employee benefit roll-backs,[16] (iii) potential layoffs affecting a wide swath of teachers, police, healthcare workers, and other public employees, and (iv) private-labor-market reforms. The following day, at the Board's twelfth public meeting, we appeared before the Board to present the Government Fiscal Plan and explain why the Board's

[16] Act No. 26 of April 29, 2017 ("Act 26"), introduced a series of changes and freezes to existing public employees' labor bargaining agreements, reductions and eliminations to previously granted public employee benefits and other fiscal control measures, including (i) freezing all public employee bargaining agreements and classification plans; (ii) implementing a maximum 15 holidays each year for Government agencies and public corporations; (iii) eliminating the annual liquidation for excess vacation and sick leave; (iv) limiting vacation benefits to 15 days per year while limiting sick leave to 18 days per year (12 days per year for new employees); (v) limiting overtime compensation; and (vi) limiting Christmas Bonuses to a maximum of $600. Although these reforms were implemented just over a year ago, the Board now asks public employees for further sacrifice while the Island is still recovering from two Category 5 storms.

recommendations were unsound and inappropriate. At the conclusion of the meeting, the Board approved and certified the Board Fiscal Plan and proposed recommendations in a divided vote.

THE GOVERNMENT REFORMS BEING INSTITUTED

Much of the Board Fiscal Plan consists of policy measures that the elected Government itself originated in the Government Fiscal Plan as a means to promote greater labor-force participation, foster on-Island investment, and generate sustainable economic growth. Because the Government has concluded that these policies are sound and in the best interest of Puerto Rico and its people, the Government is instituting the following measures:

- **EITC:** The Government will adopt an Earned Income Tax Credit ("EITC") to incentivize work and increase labor force participation among families with low to moderate incomes.

- **Work Requirement for NAP:** The Government will impose work requirements for able-bodied persons aged 18-59 to participate in the Nutritional Assistance Program ("NAP") to incentivize work and increase labor force participation.

- **WIOA and Youth Development:** The Government will update Puerto Rico's Workforce Innovation and Opportunity Act ("WIOA") plan to focus its programs and incentives on high-priority sectors and capabilities to invest more efficiently in adult education and workforce development. In addition, the Government will improve critical workplace skills through investment in youth development, higher education, and apprenticeship and training programs that target in-demand skills.

- **Ease of Doing Business:** The Government will take several targeted steps to improve Puerto Rico's rankings across a number of ease of doing business metrics, including digitizing government services and pushing a variety of permitting and regulatory changes that will decrease the time and energy required to register, run, or expand a business.

- **Infrastructure Reforms:** The Government will implement infrastructure reforms, including creating a recovery office for administering federal disaster relief[17], setting clear priorities that will guide investment, accelerating the reconstruction process, building sustainable funding models and financing strategies, and promoting procurement and delivery best practices. These reforms are necessary to efficiently manage and capitalize on federal disaster relief funding to build a more effective and resilient infrastructure.

- **Office of the CFO:** The Government will create an Office of the Chief Financial Officer ("CFO") pursuant to the public policy determination of the elected

[17] On December 6, 2017, the Public Private Partnership Authority Board formalized the creation of the CRRO as a division within the Public Private Partnership Authority.

Government, with responsibility to act as the central authority over finance, budget, human resources, audit, procurement, and cash management for all entities that receive appropriations from the general fund. These reforms are necessary to improve financial management through centralized controls, reporting, and transparency.

- **Healthcare Reform:** The Government will pursue value based reforms to improve quality relative to cost of care, reducing pharmacy spending by targeting high cost specialty drugs, reducing waste and abuse, implementing a uniform fee schedule for providers, and reducing administrative costs by converting the Island's managed care organizations to a single region model. The Government agrees that these reforms are necessary to control high costs and improve access and delivery of healthcare.

- **Tax Initiatives:** The Government will rationalize the tax code to reduce income tax rates while broadening the Island's tax base. These reforms will lower the tax burdens of individuals and businesses in a revenue neutral manner, creating a more competitive and fair tax scheme.

- **Tax Compliance:** The Government will continue to implement tax compliance reforms to reduce the complexity of the tax system and the process of filing taxes. In addition, the Government will use new technologies and systems to more effectively identify noncompliance, audit, and collect. These reforms are designed to increase revenue without increasing tax burdens, thereby increasing the overall fairness and efficiency of Puerto Rico's tax scheme.

We appreciate that the Board has recognized the value of these Government-proposed measures by including them in the Board Fiscal Plan. They are indeed the foundation for building a new, more prosperous Puerto Rico.

BOARD RECOMMENDATIONS THE GOVERNMENT DECLINES TO ADOPT

The difference between the Board's and the Government's projected savings[18] in their respective fiscal plans is largely driven by assumptions about separate and discrete policy measures the Board has recommended, but which the Government has determined to be unsound and inappropriate. Accordingly, the Government rejects all recommendations (both specific and general) contained in the Board Fiscal Plan where, in control board like fashion[19], the Board

[18] There exists a difference of only approximately $152 million annually out of a total of $25 billion between our respective projections of anticipated savings, which represents a mere difference of 1.7 percent of savings relative to addressable spending.

[19] Under the District of Columbia Financial Responsibility and Management Assistance Act of 1995 (the "D.C. Act") Congress gave the District of Columbia Financial Responsibility and Management Assistance Authority a mechanism to compel the District to implement recommendations even if the District objected. D.C. Act § 207(c)(1). While PROMESA has recommendation provisions that mirror the D.C. Act, PROMESA varies from that Act in one critical way—it does not provide a mechanism for the Board to compel the elected Government to

infringes in any manner with the Government's ability to determine how to organize its political affairs including specific assignments and decisions concerning different departments and units of the Government.

Private-Sector Human-Capital and Labor Reforms

The Board has recommended several private-sector human-capital and labor reforms that supposedly seek to drive economic growth by increasing Puerto Rico's competitiveness and labor force participation. While the Government agrees with these laudable goals, the proposed reforms are unnecessary and could be counterproductive. As stated above, the Government is instituting the EITC initiative and the work requirement for NAP as further enhancements to its already instituted comprehensive private-sector labor-reform package of 2017, the effects of which should be assessed fully before determining whether additional reforms are advisable.

Specifically, more than a year ago, the Government enacted Act No. 4 of January 26, 2017 ("Act 4") to improve Puerto Rico's competitiveness and foster economic development, while relaxing certain legal requirements for hiring and retention of employees. Specifically, Act 4 (i) established lower accrual rates for both vacation days and sick leave, (ii) approximately doubled the work hours required for accrual of Christmas Bonuses, (iii) placed a $600 cap on such bonuses, and (iv) reduced severance pay for unjust termination, among other reforms.

These reforms are sufficient now to increase labor market efficiency and revive economic growth, but their effects were forestalled as a result of the hurricanes. Allowing the Act 4 reforms to take hold will afford the Commonwealth and its people more time to recover from the hurricanes before introducing dramatic, and potentially disruptive, changes to Puerto Rico's labor market.

The Board has nevertheless recommended additional human-capital and labor reforms to address the exact same issues as Act No. 4, just in a more draconian way. The Board's proposals include:

- Converting private-sector employees to "at-will" employment beginning January 1, 2019.
- Reducing mandated paid leave, including a 50 percent reduction in sick leave and vacation pay effective immediately.
- Eliminating mandatory Christmas Bonuses by January 1, 2019.

implement recommendations over the Government's objection. H.R. REP. 114-602(I), 2016 WL 3124840, at *114 ("Under [PROMESA], the anti-democratic provision empowering the oversight board to impose its recommendations over the objection of the Puerto Rico government has been removed.").

- Increasing minimum wage for workers 25 years old and older by $0.25 per hour, effective contemporaneously with elimination of Christmas Bonuses, and tying future minimum wage increases to unattainable labor-force participation targets.

All of the Board's recommended human-capital and labor reforms will require legislation to implement—as the Board has acknowledged.[20] Such specific policy measures are recommendations under PROMESA section 205. The Board may not *require* the Government to pass legislation to adopt such recommendations. That power remains the Legislature's and Executive's sole province in areas such as pensions and labor reform and regulatory measures. The Government declines to adopt these measures because they would effectively reduce compensation for all employees when Puerto Rico's residents are still suffering the dramatic economic effects of Hurricanes Irma and Maria. The Government projects that these measures would amount to an immediate five-to-ten percent reduction in the average worker's compensation, while the cumulative effects of labor reforms would not materialize until fiscal year 2021 and would not take hold in earnest until fiscal year 2022.

Considering the unpredictable circumstances during and following Puerto Rico's disaster recovery efforts, it is a challenge to project even six years out with certain confidence, let alone 30 years. Therefore, it is crucial that the Government retain "significant flexibility" to address the ever-changing perilous and uncertain circumstances now confronting Puerto Rico.[21] Undeterred by the limits and unpredictability of financial modelling, the Board's recommendations do precisely what the Government Fiscal Plan sought to avoid: they propose that working families and retirees accept further cuts to wages, benefits, and government services today to solve for a remote potential problem based on speculative 30-year projections.

If the Board's recommended labor-market reforms were to be implemented, they would create temporary unemployment and further encourage increased population outmigration to the U.S. mainland to find new jobs. Irrespective of disaster relief funds, to be competitive with the mainland, continuation of employment protection and benefits is necessary because Puerto Rico cannot compete in terms of wages.

Pension Reforms

The Board has recommended an average 10 percent cut in pension benefits across the Government's three retirement systems—the Employees Retirement System ("ERS"), Teachers Retirement System ("TRS"), and Judicial Retirement System ("JRS"). The Board also recommends an immediate freeze of defined benefit plan obligations for JRS and TRS and conversion of those participants into a defined contribution plan with segregated retirement accounts.

[20] Board Fiscal Plan at 42. The Board Fiscal Plan attempts to mandate the Government to adopt private-sector human-capital and labor reform legislation, including its proposals, by May 31, 2018.

[21] H.R. REP. 114-602(I) (2016).

The Government rejects these recommendations as unsound because the proposed pension cuts impose a disproportionate burden on Puerto Rico's workers and retirees. These workers and retirees have already seen their benefits substantially reduced in the preceding years. In particular, three laws enacted in 2013 (Act No. 3-2013, Act 160-2013, and Act 162-2013) implemented comprehensive reforms to the three principal retirement systems. These reforms included freezing retirement benefits at ERS (largest retirement system) and thereafter accruing benefits under a defined contribution formula, increasing employee contributions, raising the retirement age, and reducing or eliminating various retirement benefits.[22]

Moreover, the Board's proposed cuts place a disproportionate burden on families. The Board's formula makes no distinction between retirees who rely on their pension benefits to support dependents and those who reside in a single-person household.[23] Under the Board's proposal, the average retiree subsisting on $15,000 per year, who relies on her pension benefit to support herself and a family of four, is subject to the same cut as a retiree whose benefit is used solely for her own support. As a result, the Board's proposed cuts would arbitrarily place the greatest burden on those retirees least able to absorb it. Further, any impairment of this group of beneficiaries over the six-year term of the Board Fiscal Plan would be inconsequential to the Government's fiscal position, but would have a devastating effect on retirees who rely on their pensions for basic necessities. Yet the Board's analysis does not consider that the proposed pension cuts could drive many pensioners to request welfare benefits, which could offset the projected savings.

Considering that 96 percent of pension payments remain on-Island, any cut to pension benefits could lead to a dramatic reduction in economic activity in Puerto Rico. By contrast, the vast majority of the Commonwealth's creditors reside on the mainland. Thus, using savings from proposed pension cuts to fund increased debt service will do little to generate economic growth in Puerto Rico.

While the Board has attempted to justify these reductions as salvaging the retirees' benefits over the long-term for their benefit, this is not the case. On August 23, 2017, the Government, through Act 106-2017, moved its three principal pension systems to a single "pay-as-you-go" system ("Pay-Go"), as the Original Fiscal Plan contemplated. The legislation implementing the Pay-Go system recognizes that the retirement systems have few remaining assets and that pensions will have to be paid mainly from current employer (i.e., Government) contributions through a Pay-Go charge. Because the Government has converted the pension system to Pay-Go, reducing benefits to retirees today will not preserve any corpus designed to finance benefits

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[22] As modified by two Puerto Rico Supreme Court decisions, one in February 2014 with respect to the JRS reform and one in April 2014 with respect to the TRS reform.

[23] Board Fiscal Plan at 112. Under the Board Fiscal Plan, although the average benefit reduction will be 10 percent there will be no reduction for those with combined retirement plan and Social Security benefits below the poverty level of $1,000 per month. *Id.* This formula is equivalent to giving each beneficiary a reduction of 25 percent in the monthly benefits they receive in excess of $600 (for retirees who also receive Social Security), and $1,000 for those without Social Security. *Id.*

in the future. Rather, every dollar not paid to retirees as part of their pensions will go to debt service to pay Puerto Rico's creditors.

In addition, there are significant legal impediments to impairing pension claims through a Title III plan of adjustment, as the Board intends to do, that must be considered in assessing whether the cuts are feasible.

Energy and Power Regulatory Reform

The Board recommends a plan to transform Puerto Rico's power sector to support the delivery of reliable and affordable power. While the Government and the Board agree on this goal, the Board Fiscal Plan seeks to dictate precisely how the Government will transform the power sector, including reforms affecting power generation mix, power grid construction, operations, capital investments, privatization, rate structures, and regulatory framework.

For the reasons discussed in my letter regarding recommendations in the New Fiscal Plan for PREPA, submitted contemporaneously herewith, many of the specific measures proposed are non-binding recommendations that the Government declines to adopt.

Reinvestment in Puerto Rico's Growth and Prosperity

The Government agrees with the goal of investing in critical areas such as healthcare, workforce readiness and skill development, and a University of Puerto Rico ("UPR") need-based scholarship fund. The Board, however, proposes to pay for these initiatives with savings generated by its human-capital and labor reforms and cuts to the Legislature and courts. In essence, the Board's proposal seeks to hold Puerto Rico's future hostage in an effort to compel the Government to adopt ill-considered policies now. Because the Government cannot support those measures, the projected savings that would fund the reinvestment will not be realized. My Administration is committed to reinvesting in Puerto Rico's future, but we will not make such investments contingent on adopting unwise and counterproductive measures mandated by the Board.

Agency Efficiencies

The Board recommends establishing targets for right-sizing government operations and recommends that the Government achieve such savings through agency consolidation, the elimination of government services, and reducing government personnel.

Agency Consolidation

The Government agrees that consolidating certain agencies will improve efficient delivery of government services and reduce administrative costs. The Government Fiscal Plan proposes right-sizing government operations through agency consolidation and reduction and elimination of certain services. The Government's efforts will include right-sizing initiatives at the Department of Education, the Department of Health, the Department of Public Safety, the

Department of Corrections and Rehabilitation, and the Department of Economic Development and Commerce, as well as consolidations and reductions in many other agencies.

The Board has no authority, however, to dictate to the Government how it will organize itself or conduct day-to-day operations. The Board also acknowledges that consolidations will require legislation to implement (which the Board cannot compel).[24] Indeed, consolidating agencies and reorganizing the elected Government is something Congress determined is appropriate only for recommendations deemed sound by the Government.[25]

The creation of the Office of the CFO will be established and structured in accordance with the public policy of the elected Government. While the Government generally agrees with the Board that creating a strong, centralized Office of the CFO will benefit the Commonwealth in many ways, the Government will not include the Puerto Rico Fiscal Agency and Financial Advisory Authority ("AAFAF")—the Government's fiscal authority and agent for purposes of its Title III and Title VI restructurings—in that consolidation. For AAFAF to perform its designated functions effectively, it needs to be independent from the CFO, at least until Puerto Rico's restructuring is complete. Moreover, for the CFO to perform the functions required to manage effectively the Government's day-to-day fiscal operations, it should remain free from the burden of managing Puerto Rico's debt restructuring efforts. The Government also declines to incorporate certain Treasury functions under the office of the CFO. In particular, the Government will transfer Treasury's financial planning and monitoring functions to the office of the CFO, while the tax collection operation remains at Treasury.

We also take issue with the Board's proposed process for ensuring that the consolidation of Government agencies yields the expected cost savings.[26] The Board Fiscal Plan attempts to give the Board the power to impose mandatory personnel cuts if the elected Government fails to meet efficiency targets. PROMESA does not grant the Board the power to force the Government to impose layoffs on public sector employees, either through the fiscal plan or budget.[27]

Puerto Rico's unemployment rate currently is significantly higher than the unemployment rate experienced by the U.S. mainland after the 2008 recession. Under these conditions, terminated Government employees will have difficulty finding new jobs in Puerto Rico. The Government's voluntary transition program will enable the Government to synchronize public employees' transition to the private sector with increased demand in that sector as Puerto Rico returns to economic growth. If, instead, as the Board recommends, public employees are simply subject to mass layoffs in the near term, the private sector will not be able to reabsorb them. Increasing the

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[24] Board Fiscal Plan at 89.

[25] *See* PROMESA § 205(a)(2) (authorizing recommendations concerning "the structural relationship of departments, agencies, and independent agencies within the territorial government").

[26] Board Fiscal Plan at 68–69.

[27] *See* PROMESA § 203(d)(2)(B)(i) (authorizing automatic hiring freezes—not layoffs—solely at territorial instrumentalities, as opposed to the Commonwealth government, to remedy budgetary noncompliance).

already-high unemployment rate through government terminations would result in increased burden on social programs across the Island, and could drive further outmigration. The elected Government's voluntary transition program will minimize the downside risks discussed above.

The Government is committed to right-sizing Government agencies, including through reducing Government personnel. But the Government believes that it can achieve its right-sizing targets through a voluntary transition program and natural attrition without resorting to unsound mass layoffs.

Cuts to Legislature and Courts

The Board also recommends cutting the Legislature's and court system's budgets by $23.6 million and $31.9 million, respectively. An efficient, well-functioning court system is critical to economic growth. As various studies have shown, reductions in court budgets lead to delay and uncertainty, resulting in dramatic decreases in economic activity.[28] Specifically, a survey of 42 states concluded that reductions in judiciary budgets "produced a decline in judicial access and significantly limited the ability of state courts to function efficiently and effectively."[29] In turn, these inefficiencies led to "delays in dispute resolution result[ing] in lost investment income of approximately $52.2 billion" over a four-year period.[30] More troubling, the negative effects of decreased access to justice are felt most acutely by low-income residents.[31]

The Board's proposed budget cuts will increase delay and uncertainty for litigants, preventing individuals and businesses from making important investment decisions that will drive Puerto Rico's recovery.[32] Thus, the savings realized by the cuts will be greatly outweighed by costs in terms of impaired access to justice and decreased economic activity.

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[28] *See, e.g.,* The Washington Economics Group, Inc., *Economic Impact on the Georgia Economy of Delays in Georgia's State Courts Due to Recent Reductions in Funding for the Courts* (2011); The Washington Economics Group, Inc., *The Economic Impacts of Delays in Civil Trials in Florida's State Courts Due to Under-Funding, Prepared for The Florida Bar* (2009); Pearsall, Shippen & Weinstein, *Economic Impact of Reduced Judiciary Funding and Resulting Delays in State Civil Litigation*, Micronomics, Inc. (2012); Porter, Stevan and Weinstein, *Economic Impact on the County of Los Angeles and the State of California of Funding Cutbacks Affecting the Los Angeles Superior Court*, Micronomics, Inc. (2009).

[29] *See* Pearsall, Shippen & Weinstein at 1.

[30] *Id.* at 2. *See also* Porter, Stevan and Weinstein (finding that reductions in funding for the County of Los Angeles Superior Court were expected to produce $15 billion in economic losses associated with increased uncertainty among litigants, damage to the Los Angeles and California economies amounting to 150,000 lost jobs, and lost local and state tax revenue of $1.6 billion).

[31] *See* Pearsall, Shippen & Weinstein at 2 (the "costs from state court budget cuts are passed on to poor and middle-class Americans who can least afford them, often resulting from delays which tend[] to increase the cost for clients").

[32] Delay extends and increases uncertainty for litigants. *Id.* at 19–20. Until the dispute is resolved, "they must operate in the presence of uncertainty." *Id.* at 19. "Uncertainty makes businesses less prone to invest and expand

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Similarly, the Legislature must be able to function, especially when the Board is recommending sweeping legislative reforms to effectuate the Board Fiscal Plan. Were the Government to adopt the recommended cuts, it could not provide essential services. The Government therefore declines to adopt the proposed cuts.

Compensation Related Initiatives

The Board also recommends additional measures affecting government-employee compensation, including (i) instituting a hiring freeze, (ii) limiting paid holidays to 15 days annually across all public employees, (iii) prohibiting carryover of sick and vacation days between fiscal years, (iv) prohibiting any future liquidation of sick and vacation days, (v) eliminating the Christmas Bonuses for all public employees, and (vi) standardizing employee healthcare benefits so that all employees receive $100 worth of benefits per month.[33] Nowhere does PROMESA authorize the Board to impose these measures—including hiring freezes—on the Commonwealth.[34]

But more fundamentally, the Government declines to adopt these inappropriate recommendations for the same reasons discussed above regarding the private-sector human-capital and labor reforms. These measures will effectively reduce government employee compensation and increase outmigration when Puerto Rico can least afford it by stripping away important protections for working families still recovering from the hurricanes.

Reduction in Appropriations to UPR

The Board recommends targets for reducing Commonwealth appropriations to UPR by $275 million by fiscal year 2023. The Board proposes to achieve the targeted savings by increasing revenue and decreasing expenses at UPR, thereby reducing UPR's need for Commonwealth appropriations. The Board seeks to dictate precisely how UPR must endeavor to achieve those savings, overstepping the Board's fiscal powers under PROMESA. For the reasons discussed in a forthcoming letter regarding the recommendations in the New Fiscal Plan for University of Puerto Rico, the specific measures proposed are non-binding recommendations that the Government declines to adopt.

Because UPR will not be implementing the recommendations submitted by the Board, the Government believes it would be unwise to deprive UPR of much needed resources by insisting that the Commonwealth reduce appropriations to UPR beyond levels provided in the Government Fiscal Plan. The Government does not believe that the additional severe cuts recommended by the Board are necessary. Further, the Board Fiscal Plan lacks clarity as to how

operations." *Id.* at 19–20. In this way, "judiciary funding cutbacks limit firms' economic growth and leads to an inefficient allocation of resources." *Id.* at 3.

[33] Board Fiscal Plan at 87–88.

[34] The Board's proposal to institute a hiring freeze exceeds its powers under PROMESA. PROMESA section 203(d)(2)(B)(i) authorizes the Board to "institute automatic hiring freezes" only at "covered instrumental[ities]" (not at the Commonwealth level) and only after the Government has failed to correct a budgetary inconsistency.

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UPR can implement the additional cuts and continue operating effectively.

* * *

My Administration has made hard choices in asking Puerto Rico's 3.4 million U.S. citizens to bear their fair share of sacrifice to achieve fiscal balance and economic prosperity for Puerto Rico in the aftermath of two devastating hurricanes. I remain hopeful that both the Government and the Board will continue to work in the same spirit of cooperation that resulted in significant agreement on the content and contours of the Government Fiscal Plan. Our reasoned determination to not accept the Board's recommendations rests on the sincere and good-faith belief that the Government must maintain significant flexibility within the domain of its exclusive policy-making powers necessary to deal with the aftershocks of last September's tragic events.

Going forward, our solemn and common endeavor with the Board must and should be to avoid intramural confrontations and instead focus on restructuring Puerto Rico's outstanding debt without further distraction or delay. Using the tools provided by Congress under Title III of PROMESA, we should jointly forge ahead to achieve an equitable and balanced restructuring of that debt, one in which all of Puerto Rico's stakeholders share in the sacrifice. We steadfastly stand ready to partner closely with the Board and all of Puerto Rico's stakeholders to proceed with this task. The fruits of our success meeting this important challenge will advance and ensure the dawn of Puerto Rico's long awaited dream of lasting economic growth and prosperity for its people.

Most respectfully,

Ricardo Rosselló Nevares
Governor of Puerto Rico

cc: Members of the Financial Oversight
and Management Board of Puerto Rico